

CAROLINE ISLANDS AIR, INC.

**(A COMPONENT UNIT OF THE FEDERATED STATES OF
MICRONESIA NATIONAL GOVERNMENT)**

**FINANCIAL STATEMENTS AND
INDEPENDENT AUDITORS' REPORT**

YEARS ENDED SEPTEMBER 30, 2019 AND 2018

CAROLINE ISLANDS AIR, INC.
(A COMPONENT UNIT OF THE FSM NATIONAL GOVERNMENT)

Years Ended September 30, 2019 and 2018
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INDEPENDENT AUDITORS' REPORT

Board of Directors
Caroline Islands Air, Inc.:

Report on the Financial Statements

We have audited the accompanying financial statements of Caroline Islands Air, Inc., a component unit of the Federated States of Micronesia National Government, which comprise the statements of net position as of September 30, 2019 and 2018, and the related statements of revenues, expenses and changes in net position and of cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Caroline Islands Air, Inc. as of September 30, 2019 and 2018, and the changes in its financial position and its cash flows, for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter

As discussed in Note 7 to the financial statements, the Company determined that the COVID-19 may have significant negative impact on its operations but is currently unable to reasonably estimate the effects on its financial and operational results. Our opinion is not modified with respect to this matter.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the Management's Discussion and Analysis on pages 3 to 5 be presented to supplement the financial statements. Such information, although not a part of the financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the financial statements, and other knowledge we obtained during our audit of the financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated February 25, 2021, on our consideration of Caroline Islands Air, Inc.'s internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is solely to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the effectiveness of Caroline Islands Air, Inc.'s internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Caroline Islands Air, Inc.'s internal control over financial reporting and compliance.

Deloitte & Touche LLP

February 25, 2021

CAROLINE ISLANDS AIR, INC.
(A COMPONENT UNIT OF THE FSM NATIONAL GOVERNMENT)

Management's Discussion and Analysis
Years Ended September 30, 2019 and 2018

This section of the Caroline Islands Air, Inc. (CIA) annual audit report presents the Management's Discussion and Analysis (MD&A) for the fiscal years ended September 30, 2019 and 2018. MD&A is a supplementary information required by the Governmental Accounting Standards Board Statement No. 34 (GASB 34) on reporting model. The preparation of MD&A is the responsibility of the management of CIA, and it is designed to help the reader in understanding the accompanying financial statements and notes to the financial statements.

Background

Caroline Islands Air, Inc. is a government owned corporation, created under Public Law No. 10-72 by the Congress of the Federated States of Micronesia (FSM). The main purpose of CIA is to (1) provide air transportation services throughout the Nation, (2) contract with domestic and foreign persons and corporations for the provisions of aircraft and services, (3) operate domestic air transportation, (4) train citizens in professions related to aeronautics, (5) act as a "Freely Associated State Air Carrier" within the meaning of the Federal Program and Services Agreement concluded pursuant to the Compact of Free Association, (6) engage in support activities, included but not limited to, freight terminal and delivery activities and passenger services, and (7) enter into joint ventures with other entities in order to effectuate its operation.

Overview of Fiscal Year 2019

The accounts of CIA are organized as a proprietary fund. Proprietary funds are used by governmental units that are operated in a manner similar to private business enterprises.

For the current year, CIA's operations include regular/charter flight services and cargo.

In fiscal year 2019, operating revenue sources of CIA's operations are from \$513k of passenger airfare, \$376k of charter services, \$128k of baggage fees, and \$33k of freight and others.

Financial Highlights

1. Statement of Net Position

Statement of Net Position presents what CIA owns (assets), owes (liabilities) and the net position (the difference between total assets and total liabilities) at the end of the fiscal year. The "net position" is one indicator of whether the current financial condition has improved or worsened during the year.

Comparative Statements of Net Position at September 30, 2019, 2018 and 2017 are summarized below:

	<u>2019</u>	<u>2018</u>	<u>2017</u>
Assets:			
Current assets	\$ 595,161	\$ 417,726	\$ 623,851
Capital assets	<u>25,097</u>	<u>32,499</u>	<u>26,716</u>
Total assets	<u>\$ 620,258</u>	<u>\$ 450,225</u>	<u>\$ 650,567</u>
Liabilities:			
Current liabilities	\$ <u>49,414</u>	\$ <u>42,590</u>	\$ <u>9,363</u>
Total liabilities	<u>49,414</u>	<u>42,590</u>	<u>9,363</u>

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Management's Discussion and Analysis
Years Ended September 30, 2019 and 2018

Comparative Statements of Net Position at September 30, 2019, 2018 and 2017 are summarized below, continued:

	<u>2019</u>	<u>2018</u>	<u>2017</u>
Net position:			
Net investment in capital assets	25,097	32,499	26,716
Unrestricted	<u>545,747</u>	<u>375,136</u>	<u>614,488</u>
Total net position	<u>570,844</u>	<u>407,635</u>	<u>641,204</u>
	\$ <u>620,258</u>	\$ <u>450,225</u>	\$ <u>650,567</u>

Assets: Total assets of \$620k comprise \$595k or 96% of current assets and \$25k or 4% of capital assets.

Current assets: Total current asset of \$595k comprised \$297k or 50% of cash, \$175k or 29% of insurance claims receivable, \$54k or 9% of prepaid expense, \$69k or 12% of inventory and others.

Noncurrent assets: The noncurrent assets of \$25k comprise the Company's property and equipment, net of accumulated depreciation.

Liabilities: CIA's liabilities of \$49k are all current consisting of accounts payable, accrued liabilities and others.

2. Summary Statement of Revenues, Expenses and Changes in Net Position

The following table provides information on the financial performance of the current year in terms of revenues and expenses. It presents the operating revenues and expenses and the corresponding net operating results, as well as non-operating revenues and expenses.

Below is the comparative summary of Statement of Revenues, Expenses and Changes in Net Position for the fiscal years ended September 30, 2019, 2018 and 2017.

	<u>2019</u>	<u>2018</u>	<u>2017</u>
Operating revenues	\$ 1,051,923	\$ 813,435	\$ 692,068
Cost of operating revenues	<u>(1,190,724)</u>	<u>(1,136,003)</u>	<u>(576,133)</u>
Gross (loss) profit	(138,801)	(322,568)	115,935
General and administrative expenses	<u>(117,427)</u>	<u>(98,008)</u>	<u>(45,424)</u>
Operating (loss) income	(256,228)	(420,576)	70,511
Nonoperating income	419,437	187,007	29,638
Capital contribution	<u>-</u>	<u>-</u>	<u>28,122</u>
Change in net position	163,209	(233,569)	128,271
Net position at beginning of year	<u>407,635</u>	<u>641,204</u>	<u>512,933</u>
Net position at end of year	\$ <u>570,844</u>	\$ <u>407,635</u>	\$ <u>641,204</u>

Fiscal year 2019 operating revenue sources of CIA operations are from \$513k of passenger airfare, \$377k of charter services, \$129k of baggage fees, and \$33k of freight and others.

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Management's Discussion and Analysis
Years Ended September 30, 2019 and 2018

During the year ended September 30, 2019, the Company recorded \$175K as insurance receivable for an incident involving one of the Company's aircrafts.

3. Summary Statement of Cash Flows

The following table presents information about changes in the cash position using the direct method of reporting sources and uses of cash. The direct method reports all major cash inflows and outflows at gross amounts, differentiating the activities into cash flows arising from operating activities, noncapital financing and capital and related financing.

Below are the summary Statements of Cash Flows:

	<u>2019</u>	<u>2018</u>	<u>2017</u>
Cash flows (used in) provided by operating activities	\$ (185,235)	\$ (506,603)	\$ 143,590
Cash flows provided by noncapital financing activities	253,300	187,007	19,171
Cash flows used in capital and related financing activities	<u>-</u>	<u>(8,892)</u>	<u>-</u>
Net change in cash	68,065	(328,488)	162,761
Cash at beginning of year	<u>229,432</u>	<u>557,920</u>	<u>395,159</u>
Cash at end of year	\$ <u>297,497</u>	\$ <u>229,432</u>	\$ <u>557,920</u>

4. Debt and Capital Asset Activities

For additional information on capital assets, please refer to note 3 to the financial statements.

Economic Outlook

CIA continues to face challenges in FY2019 due to increase in insurance cost and maintenance and operation costs related to fuel, aircraft parts and periodic overhaul of airplane parts. These operating issues are the continued revenue shortfalls to adequately cover operating costs, insurance, fuel and parts for airplanes and periodic overhaul of airplane parts.

In the subsequent year, FY 2020, CIA faced a major loss in revenues due to COVID-19 related issues resulting in the decrease in its operation. During such time, the Yap/Palau operation discontinued and the primary aircraft was relocated to Pohnpei in order to supplement transportation services within the country. Following the relocation, CIA went through a transition period that involved change in management and staff. Given the travel restrictions imposed by the FSM National Government and the states in response to COVID-19, CIA again faced challenges in recruiting crews that will continue its operations. For a period of over three months, CIA continues to pay for its non-operating activities without generating any revenues.

Management's Discussion and Analysis for the year ended September 30, 2018, is set forth in the report on the audit of financial statements, which is dated June 26, 2019. That Discussion and Analysis explains the major factors impacting the 2018 financial statements and can be viewed at the FSM Office of the National Public Auditors' website at www.fsmopa.fm.

Financial Management Contact

This financial report is designed to provide all interested users with a general overview of the Company's finances. Inquiries concerning this report, if any, may be directed to Caroline Islands Air, Inc., P.O. Box 2238, Kolonia Pohnpei, and FM96941.

CAROLINE ISLANDS AIR, INC.
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Statements of Net Position
September 30, 2019 and 2018

<u>ASSETS</u>	<u>2019</u>	<u>2018</u>
Current assets:		
Cash	\$ 297,497	\$ 229,432
Insurance claims receivable	175,000	-
Trade receivables	-	3,375
Prepaid inventory	-	120,044
Prepaid expense	53,720	35,182
Inventory	68,944	29,693
Total current assets	<u>595,161</u>	<u>417,726</u>
Capital assets, net	<u>25,097</u>	<u>32,499</u>
	<u>\$ 620,258</u>	<u>\$ 450,225</u>
<u>LIABILITIES AND NET POSITION</u>		
Current liabilities:		
Accounts payable	\$ 29,961	\$ 22,960
Accrued liabilities and others	19,453	19,630
Total liabilities	<u>49,414</u>	<u>42,590</u>
Commitments		
Net position:		
Net investment in capital assets	25,097	32,499
Unrestricted	545,747	375,136
Total net position	<u>570,844</u>	<u>407,635</u>
	<u>\$ 620,258</u>	<u>\$ 450,225</u>

See accompanying notes to financial statements.

CAROLINE ISLANDS AIR, INC.
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Statements of Revenues, Expenses, and Changes in Net Position
Years Ended September 30, 2019 and 2018

	2019	2018
Operating revenues:		
Passenger airfare	\$ 513,054	\$ 394,702
Charter services	376,738	203,945
Baggage fees	128,575	142,216
Freight	30,806	71,141
Service fees	2,585	1,256
Drums	165	175
Total operating revenues	1,051,923	813,435
Operating costs:		
Maintenance and operation	480,995	616,438
Salaries and housing	301,900	268,838
Insurance	215,156	119,329
Contract labor	96,347	70,352
Rent	54,611	44,623
Taxes	34,313	13,314
Depreciation	7,402	3,109
Total operating costs	1,190,724	1,136,003
Gross loss	(138,801)	(322,568)
General and administrative expenses:		
Travel	58,419	37,284
Supplies	24,345	27,847
Utilities	19,224	13,703
Communications	10,116	10,122
Professional fees	2,975	3,731
Bank service fees	1,165	1,057
Miscellaneous	1,183	4,264
Total general and administrative expenses	117,427	98,008
Operating loss	(256,228)	(420,576)
Nonoperating income (expense):		
Subsidies from the FSM National Government	253,300	187,007
Extraordinary item - insurance recoveries	175,000	-
Other expense	(8,863)	-
Nonoperating income	419,437	187,007
Change in net position	163,209	(233,569)
Net position at beginning of year	407,635	641,204
Net position at end of year	\$ 570,844	\$ 407,635

See accompanying notes to financial statements.

CAROLINE ISLANDS AIR, INC.
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Statements of Cash Flows
Years Ended September 30, 2019 and 2018

	2019	2018
Cash flows from operating activities:		
Cash received from customers	\$ 1,055,298	\$ 810,060
Cash paid to suppliers for goods and services	(938,633)	(1,047,825)
Cash paid to employees for services	(301,900)	(268,838)
Net cash used in operating activities	(185,235)	(506,603)
Cash flows from noncapital financing activities:		
Subsidies from the FSM National Government	253,300	187,007
Net cash provided by noncapital financing activities	253,300	187,007
Cash flows from capital and related financing activities:		
Acquisition of capital assets	-	(8,892)
Net cash used in capital and related financing activities	-	(8,892)
Net change in cash	68,065	(328,488)
Cash at beginning of year	229,432	557,920
Cash at end of year	\$ 297,497	\$ 229,432
Reconciliation of operating income to net cash used in operating activities:		
Operating loss	\$ (256,228)	\$ (420,576)
Adjustments to reconcile operating loss to net cash used in operating activities:		
Other expense	(8,863)	-
Depreciation	7,402	3,109
(Increase) decrease in assets:		
Trade receivables	3,375	(3,375)
Prepaid inventory	120,044	(120,044)
Prepaid expense	(18,538)	(25,486)
Inventory	(39,251)	26,542
Increase (decrease) in liabilities:		
Accounts payable	7,001	22,960
Accrued liabilities and others	(177)	10,267
Net cash used in operating activities	\$ (185,235)	\$ (506,603)

See accompanying notes to financial statements.

CAROLINE ISLANDS AIR, INC.
(A COMPONENT UNIT OF THE FSM NATIONAL GOVERNMENT)

Notes to Financial Statements
September 30, 2019 and 2018

(1) Organization

Caroline Islands Air, Inc. ("CIA" or the "Company") is a component unit of the Federated States of Micronesia (FSM) National Government. CIA was created under Public Law 10-72, as passed by the FSM Congress and was signed into law on December 27, 1997, for the purpose of providing the following services:

- Provide air transportation service throughout FSM;
- Contract with domestic and foreign persons and corporations for the provisions of aircraft and services;
- Operate domestic air transportation;
- Train citizens in professions related to aeronautics;
- Act as a "Freely Associated State Air Carrier" within the meaning of the Federal Program and Services Agreement concluded pursuant to the Compact of Free Association;
- Engage in support activities, included but not limited to, freight terminal and delivery activities and passenger services; and
- Enter into joint ventures with other entities in order to effectuate its operation.

For the years ended September 30, 2019 and 2018, CIA has operated in the states of Pohnpei and Chuuk. Additionally, it began operation in Yap and Republic of Palau in January 2018.

CIA is governed by a six-member Board of Directors appointed as follows:

- 1 member appointed by the President with the advice and consent of the FSM Congress to represent the FSM National Government;
- 4 State representatives appointed by the President with the advice and consent of the FSM Congress upon the recommendation to the President by the Governor of the pertinent State; and
- The Chief Executive Officer of CIA as ex officio but without rights to vote.

CIA's financial statements are incorporated into the financial statements of the FSM National Government as a component unit.

(2) Summary of Significant Accounting Policies

Basis of Accounting

CIA utilizes the flow of economic resources measurement focus. The financial statements are prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) as applied to governmental units using the accrual basis of accounting. Revenues are recognized when earned and expenses are recognized when incurred. The Governmental Accounting Standards Board (GASB) is the accepted standard-setting body for establishing governmental accounting and financial reporting principles.

Net Position

Net position represents the residual interest in CIA's assets after liabilities are deducted and consists of the following categories:

Net investment in capital assets - include capital assets, net of accumulated depreciation, reduced by outstanding debt, net of debt service reserve.

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Notes to Financial Statements
September 30, 2019 and 2018

(2) Summary of Significant Accounting Policies, Continued

Net Position, Continued

Restricted nonexpendable - net position subject to externally imposed stipulations that require CIA to maintain them permanently.

Restricted expendable - net position whose use is subject to externally imposed stipulations that can be fulfilled by actions of CIA pursuant to those stipulations or that expire with the passage of time.

Unrestricted - net position that is not subject to externally imposed stipulations. Unrestricted net position may be designated for specific purposes by action by management or the Board of Directors or may otherwise be limited by contractual agreements with outside parties.

Operating and Non-Operating Revenue and Expenses

CIA considers passenger and related charter and cargo revenues and costs directly related to such revenues to be operating revenues and expenses. Revenues and expenses related to financing and other activities are reflected as nonoperating.

Cash

Custodial credit risk is the risk that in the event of a bank failure, CIA's deposits may not be returned to it. Such deposits are not covered by depository insurance and are either uncollateralized or collateralized with securities held by the pledging financial institution or held by the pledging financial institution but not in the depositor-government's name. CIA does not have a deposit policy for custodial credit risk.

As of September 30, 2019 and 2018, the carrying amount of CIA's total cash was \$297,497 and \$229,432, respectively, and the corresponding bank balances were \$333,815 and \$317,315, respectively, all of which were maintained in financial institutions subject to Federal Deposit Insurance Corporation (FDIC) insurance. As of September 30, 2019 and 2018, bank deposits in the amount of \$323,514 and \$262,070, respectively, were FDIC insured. CIA does not require collateralization of its cash deposits; therefore, deposit levels in excess of FDIC insurance coverage are uncollateralized. Accordingly, these deposits are exposed to custodial credit risk. CIA has not experienced any losses in such accounts and management believes it is not exposed to any significant custodial credit risk on its deposits.

Trade Receivables

CIA's trade receivables are with businesses and governments that relate to passenger, cargo and charter charges. The allowance for uncollectible accounts is stated at an amount which management believes is adequate to absorb losses that may become uncollectible. The allowance is established through a provision for bad debts expense and netted with the accounts receivable for reporting purposes. There is no outstanding balance of the allowance for doubtful accounts as of September 30, 2019 and 2018.

Prepaid Expense

Prepaid expense consists of insurance premiums paid for the unelapsed policy period.

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Notes to Financial Statements
September 30, 2019 and 2018

(2) Summary of Significant Accounting Policies, Continued

Inventory

CIA's inventory consists of Avgas and jet fuel in drums. Inventory is substantially carried at the lower of cost (first-in, first-out) or market.

Capital Assets

CIA capitalizes individual items with estimated useful lives of more than five years and the purchase cost of more than \$1,000. Depreciation of property and equipment is calculated using the straight-line method over the estimated useful lives of the assets. Estimated useful lives of property and equipment are as follows:

Motor vehicles	5 years
Equipment	5 years
Furniture and fixtures	5 years

Risk Management

CIA purchases insurance to cover accidental damage or loss to aircraft hulls. Additionally, liability insurance is obtained against CIA's legal liability to third parties and passengers for accidental bodily injury and accidental damage to property including cargo, freight and mail. CIA is substantially self-insured for all other risks. Management is of the opinion that no material loss has been sustained as a result of this practice for the past three years.

In September 2019, a plane owned by the FSM National Government (see note 6) and operated by CIA had an accident. CIA, as the insured party, claimed and received insurance proceeds of \$175,000 subsequent to September 30, 2019. As the plane was owned by the FSM National Government, no losses were recorded by CIA and the settlement was recorded as an extraordinary item from insurance recovery as of September 30, 2019 in the accompanying financial statements.

New Accounting Standards

During the year ended September 30, 2019, CIA implemented the following pronouncements, which did not have a material effect on the accompanying financial statements.

- GASB Statement No. 83, *Certain Asset Retirement Obligations*, which addresses accounting and financial reporting for certain asset retirement obligations (AROs) associated with the retirement of a tangible capital asset.
- GASB Statement No. 88, *Certain Disclosures Related to Debt, including Direct Borrowings and Direct Placements*, which improves the information that is disclosed in notes to government financial statements related to debt, including direct borrowings and direct placements.

In January 2017, GASB issued Statement No. 84, *Fiduciary Activities*, which establishes criteria for identifying fiduciary activities of all state and local governments. The provisions in Statement No. 84 are effective for fiscal years beginning after December 15, 2018. Management does not believe that the implementation of this statement will have a material effect on the financial statements.

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Notes to Financial Statements
September 30, 2019 and 2018

(2) Summary of Significant Accounting Policies, Continued

New Accounting Standards, Continued

In June 2017, GASB issued Statement No. 87, *Leases*, which establishes a single model for lease accounting based on the foundational principle that leases are financings of the right to use an underlying asset. The provisions in Statement No. 87 are effective for fiscal years beginning after December 15, 2019. Management has yet to determine whether the implementation of this statement will have a material effect on the financial statements.

In June 2018, GASB issued Statement No. 89, *Accounting for Interest Cost Incurred before the End of a Construction Period*, which requires that interest cost incurred before the end of a construction period be recognized as an expense in the period in which the cost is incurred for financial statements prepared using the economic resources measurement focus. The provisions in Statement No. 89 are effective for fiscal years beginning after December 15, 2019. Management does not believe that the implementation of this statement will have a material effect on the financial statements.

In August 2018, GASB issued Statement No. 90, *Majority Equity Interests - an Amendment of GASB Statements No. 14 and No. 61*, which improves the consistency and comparability of reporting a government's majority equity interest in a legally separate organization and the relevance of financial statement information for certain component units. The provisions in Statement No. 90 are effective for fiscal years beginning after December 15, 2018. Management does not believe that the implementation of this statement will have a material effect on the financial statements.

In May 2019, GASB issued Statement No. 91, *Conduit Debt Obligations*, which clarifies the existing definition of a conduit debt obligation; establishing that a conduit debt obligation is not a liability of the issuer; establishing standards for accounting and financial reporting of additional commitments and voluntary commitments extended by issuers and arrangements associated with conduit debt obligations; and improving required note disclosures. The provisions in Statement No. 91 are effective for fiscal years beginning after December 15, 2020. Management does not believe that the implementation of this statement will have a material effect on the financial statements.

In May 2020, GASB issued Statement No. 95, *Postponement of the Effective Dates of Certain Authoritative Guidance*, which postpones the effective dates of GASB Statement No. 84, 89, 90 and 91 by one year and GASB Statement No. 87 by 18 months; however, earlier application of the provisions addressed in GASB Statement No. 95 is encouraged and is permitted to the extent specified in each pronouncement as originally issued. Management has yet to ascertain whether implementation of these statements will be postponed as provided in GASB Statement No. 95.

Management Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Reclassifications

Certain accounts in the September 30, 2018 statement of revenues, expenses and changes in net position were reclassified to conform to the September 30, 2019 presentation.

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Notes to Financial Statements
September 30, 2019 and 2018

(3) Capital Assets

Capital asset activities for the years ended September 30, 2019 and 2018 are as follows:

	Balance at October <u>1, 2018</u>	Transfers and <u>Additions</u>	Transfers and <u>Deletions</u>	Balance at September <u>30, 2019</u>
Motor vehicles	\$ 56,790	\$ -	\$ -	\$ 56,790
Equipment	10,300	-	-	10,300
Furniture and fixtures	<u>1,638</u>	-	-	<u>1,638</u>
	68,728	-	-	68,728
Less accumulated depreciation	<u>(36,229)</u>	<u>(7,402)</u>	-	<u>(43,631)</u>
	\$ <u>32,499</u>	\$ <u>(7,402)</u>	\$ -	\$ <u>25,097</u>
	Balance at October <u>1, 2017</u>	Transfers and <u>Additions</u>	Transfers and <u>Deletions</u>	Balance at September <u>30, 2018</u>
Motor vehicles	\$ 47,898	\$ 8,892	\$ -	\$ 56,790
Equipment	10,300	-	-	10,300
Furniture and fixtures	<u>1,638</u>	-	-	<u>1,638</u>
	59,836	8,892	-	68,728
Less accumulated depreciation	<u>(33,120)</u>	<u>(3,109)</u>	-	<u>(36,229)</u>
	\$ <u>26,716</u>	\$ <u>5,783</u>	\$ -	\$ <u>32,499</u>

(4) Commitments

Leases

CIA operates a hangar through an annual lease with the Pohnpei Port Authority, a component unit of the State of Pohnpei. Annual rent is \$8,556, and the current lease term expiration is in October 2021.

CIA also leases office space in Pohnpei, a storage space in Chuuk and apartments in Pohnpei, Yap and Palau under month-to-month agreements.

(5) Contract Labor

Details of contract labor for the years ended September 30, 2019 and 2018 are as follows:

	<u>2019</u>	<u>2018</u>
Overtime in Palau	\$ 20,735	\$ 39,535
Ground handling in Palau	64,000	19,383
Overtime in the FSM	8,612	5,066
Airport cleaning and maintenance	-	3,968
Other contract cost	<u>3,000</u>	<u>2,400</u>
	\$ <u>96,347</u>	\$ <u>70,352</u>

CAROLINE ISLANDS AIR, INC.
(A COMPONENT UNIT OF THE FSM NATIONAL GOVERNMENT)

Notes to Financial Statements
September 30, 2019 and 2018

(6) Related Party Transactions

For the years ended September 30, 2019 and 2018, \$72,776 and \$67,538, respectively, of operating revenues were earned from the FSM National Government.

During the years ended September 30, 2019 and 2018, CIA received \$253,300 and \$187,007, respectively, of subsidies from the FSM National Government.

CIA utilizes airplanes owned by the FSM National Government at no cost.

(7) Subsequent Event

As a result of the spread of COVID-19 coronavirus, governments worldwide, including FSM, Guam and Republic of Palau implemented actions to restrict travel. Such restrictions have resulted in negative impact on the CIA's operations, including decreased revenues due to limited flights. The duration and the ultimate effects of such negative impacts are unknown at this time.

Management has considered subsequent events through February 25, 2021 upon which the financial statements were available to be issued. Except for the matter discussed above, there were no other material subsequent events that would require recognition or disclosure in the financial statements for the year-ended September 30, 2019.

INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS

Board of Directors
Caroline Islands Air, Inc.:

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of Caroline Islands Air, Inc. (the Company), which comprise the statement of net position as of September 30, 2019, and the related statements of revenues, expenses and changes in net position and of cash flows for the year then ended and the related notes to the financial statements, and have issued our report thereon dated February 25, 2021.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the Company's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control. Accordingly, we do not express an opinion on the effectiveness of the Company's internal control.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. *A material weakness* is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. *A significant deficiency* is a deficiency, or a combination of deficiencies, in internal control over financial reporting, that is less severe than a material weakness yet important enough to merit attention by those responsible for oversight of the company's financial reporting.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified. We did identify certain deficiencies in internal control, described in the accompanying Schedule of Findings and Responses as item 2019-001 that we consider as significant deficiencies.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Company's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

The Company's Response to Findings

The Company's responses to findings identified in our audit are described in the accompanying Schedule of Findings and Responses. The Company's responses were not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on them.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Deloitte & Touche LLP

February 25, 2021

CAROLINE ISLANDS AIR, INC.
(A COMPONENT UNIT OF THE FSM NATIONAL GOVERNMENT)

Schedule of Findings and Responses
Year Ended September 30, 2019

Finding No. : 2019-001

Proper Safekeeping of Source Documentation

Criteria: An effective control includes policies and procedures requiring source documentation such as flight manifest, invoice, receipts and other pertinent documents for all recorded transactions be adequately safeguarded and filed.

Condition: During the course of audit we have noted the following exceptions:

- Of twelve charter services revenue items tested (totaling \$113, 655), the supporting flight or cargo manifest was not made available for the following items:

<u>GL Name/no.</u>	<u>Date</u>	<u>Amount</u>
2018Y12 Charter Yap-Wolei-Yap	09/06/2019	\$ 10,900
4020 Charter Services	03/08/2019	4,600
4020 Charter Services	09/20/2019	40,000
Total		\$ <u>55,500</u>

- Of eighteen passenger airfare items (totaling \$25,554) and five baggage fees (totaling \$2,968) revenue items tested, the supporting flight manifest and related baggage receipts were not made available for the following items:

<u>GL Name/no.</u>	<u>Date</u>	<u>Amount</u>
2018Y12 Passenger Airfare-Palau	04/24/2019	\$ 1,400
2018Y12 Passenger Airfare-Palau	08/13/2019	7,990
C.I.A. REVENUE:2018Y12		
Baggage Yap-Wolaie-Yap	01/07/2019	751
2018Y12 Pass. Exs Bagge, Palau	01/07/2019	320
2018Y12 Pass. Exs Bagge, Palau	04/24/2019	921
2018Y12 Pass. Exs Bagge, Palau	08/13/2019	900
Total		\$ <u>12,282</u>

- Of ten payroll transactions (totaling \$8,020), the source employment contact/PAF, basis of hours and hourly rate were not made available. Thus, we were not able to determine the basis of gross pay and the validity or accuracy of the payroll expense for the following items:

<u>Check no.</u>	<u>Date</u>	<u>Amount</u>
11520	11/21/2018	\$ 200
12264	07/03/2019	100
11667	12/24/2018	73
12111	05/22/2019	<u>2,500</u>
Total		\$ <u>2,873</u>

- One payroll transaction (check#12405) noted a pay rate increase based on satisfied certification, which was not made available. Additionally, one payroll transaction (check#11938) was supported with a check voucher and time sheet but employment contract or PAF was not made available.

CAROLINE ISLANDS AIR, INC.
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Schedule of Findings and Responses
Year Ended September 30, 2019

Finding No. : 2019-001, Continued

- Vendor invoices and receiving records for the following fuel purchases could not be located. The Company reached out to the vendors to obtain a copy of invoices at the auditor’s request for the items selected for testing.

<u>Check no.</u>	<u>Date</u>	<u>Amount</u>
11692	01/11/2019	\$ 6,000
11947	03/20/2019	6,000
12093	05/20/2019	8,764
12392	08/13/2019	2,707
12568	10/10/2019	6,000
Wire transfer	03/12/2019	<u>9,426</u>
Total		\$ 38,897

- The signed and approved journal entries for the following journal entries could not be provided:

<u>Journal no.</u>	<u>Date</u>	<u>Amount</u>
AJE#10	09/30/2019	\$ 15,848
AJE#24	09/30/2019	\$ 36,649

Cause: The cause of the above the condition is lack of periodic monitoring of proper safekeeping of pertinent documents such as invoices, employee contract, approved journal entries, related supporting check disbursement/payroll vouchers and manifests/receipts.

Effect: The effect of the above condition is the potential misstatements of financial statements, including the potential disbursements of Company funds for unsupported transactions.

Recommendation: Management should establish policies and procedures for the proper safekeeping, filing and retention of source documents that support the validity and occurrence of transactions.

Auditee Response and Corrective Action Plan: The Company agrees with the finding and describes corrective action in the Corrective Action Plan.

CAROLINE ISLANDS AIR, INC.
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Unresolved Prior Year Findings
Year Ended September 30, 2019

Summary Schedule of Prior Audit Findings:

There were no unresolved audit findings from the prior year audits of the Company.



Caroline Islands Air,

"Wings of the FSM"

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Corrective Action Plan
2 CFR§200.511©
Year Ended September 30, 2019

Finding No.2019-001	Corrective Action Plan	Anticipated Date	Responsible Person
Of twelve charter services revenue items tested (totaling \$113, 655), the supporting flight or cargo manifest was not made available.	We agree to these findings. With the new management on board, it is our intention to start implementing requirements for maintenance of records to ensure that all transactions are sufficiently supported.	March 31, 2021	Management, CIA
Of eighteen passenger airfare items (totaling \$25,554) and five baggage fees (totaling \$2,968) revenue items tested, the supporting flight manifest and related baggage receipts were not made available.			
Of ten payroll transactions (totaling \$8, 020), the source employment contact/PAF, basis of hours and hourly rate were not made available. Thus, we were not able to determine the basis of gross pay and the validity or accuracy of the payroll expenses.	We agree to these findings. Management has already discussed this issue and will ensure that all permanent employees (non-contract employees) have a Personnel Action (PA) indicating pay rate, effective date of employment and all other required information upon hiring. Further, for all re-classification of employees, management will ensure that a PA shall be prepared indicating increase in pay rate and shall be adequately supported and approved.	March 31, 2021	Management, CIA
One payroll transaction (check#12405) noted a pay rate increase based on satisfied certification, which was not made available. Additionally, one payroll transaction (check#11938) was supported with a check voucher and time sheet but with employment contract or PAF was not made available.			
Vendor invoices and receiving records for the following fuel purchases could not be located. The Company reached out to the vendors to obtain a copy of invoices at the auditor's request for the items selected for testing.	We agree to this finding. Management had requested the vendor to start providing delivery reports and vendor receipts upon delivery of services and will continue to ensure that such is provided.	March 31, 2021	Management, CIA
The signed and approved journal entries for the following journal entries could not be provided.	We agree to this finding	6/30/2021	Management, CIA